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No. 02-575

IN THE

Supreme Court of the United States

NIKE INC., *et al.*,

Petitioners,

v.

MARC KASKY,

Respondent.

On Writ of Certiorari to the Supreme Court of California

BRIEF OF DOMINI SOCIAL INVESTMENTS LLC, KLD RESEARCH & ANALYTICS, INC., AND HARRINGTON INVESTMENTS, INC., AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

JAMES E. PFANDER *
CYNTHIA A. WILLIAMS
THE UNIVERSITY OF ILLINOIS,
COLLEGE OF LAW
504 East Pennsylvania Avenue
Champaign, IL 61820
(217) 333-8237

ADAM M. KANZER
General Counsel
DOMINI SOCIAL INVESTMENTS LLC
536 Broadway, 7th Floor
New York, N.Y. 10012

MICHAEL R. SIEBECKER
HUNTER COLLEGE
695 Park Avenue
New York, N.Y. 10021

* Counsel of Record

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INTEREST OF *AMICI CURIAE*[1]

Domini Social Investments LLC is an investment adviser registered with the Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940, specializing exclusively in socially responsible investing ("SRI"). Domini manages more than $1.3 billion in assets for individual and institutional mutual fund investors who integrate social, environmental, and financial criteria into their investment decisions. KLD Research & Analytics, Inc. ("KLD") is a leading provider of social research for institutional investors, serving clients who wish to integrate social and environmental criteria into their investment decisions. KLD provides performance benchmarks, corporate accountability research, and consulting services.

Harrington Investments, Inc. ("HII"), based in Napa, California, is a registered investment advisor, managing assets for individual and institutional clients using comprehensive social, environmental and financial criteria.

SUMMARY OF ARGUMENT

The principal difference between political and commercial speech is the role of the government in ensuring accuracy. While government has no role to play in winnowing false from true political ideas, it has a role to play in ensuring that facts of commercial significance are accurate. This role derives directly from the reason commercial speech is given constitutional protection, which is to inform consumers and promote market efficiency.

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[1] Consents to the filing of any and all briefs *amicus curiae* have been granted by counsel for Petitioners and Respondent, as indicated on the U.S. Supreme Court docket. Pursuant to Rule 37.6, counsel for *amici* state that this brief was authored by the professors of law or political science and counsel listed on the front cover hereto, and was not authored by counsel for any party. No one other than *amici,* and the authors, made a monetary contribution to the preparation of this brief.

Consumers and investors are increasingly taking social and environmental facts into account in their purchasing and investment decisions, and thus these facts are properly understood as commercial speech. The goal of encouraging accurate corporate disclosure is best achieved by ensuring that the States and the federal government maintain the power to regulate the type of speech at issue here: factual representations by a commercial entity about that company's operations and products to an audience of potential consumers. The test the California Supreme Court articulated allows a proper role for government, recognizing that promoting accurate consumer information is the core value to be advanced by the commercial speech doctrine and is a necessary condition for the functioning of a free-market economy.

In contrast, Petitioner's expansive view of political speech, encompassing factual statements by any entity, including a commercial entity, about its operations related to a matter of public concern, not only threatens important consumer protection values, but could have serious unintended consequences for regulation of the capital markets. Securities regulation in the United States is premised upon compelled disclosure of specified information in connection with specified types of transactions. This Court has struck down compelled disclosure of political speech, however. The securities laws also contain numerous causes of action for false and misleading statements of fact that could be undermined if Petitioner's expansive view pre-vails. Finally, shareholders' power to continue to bring important matters to the attention of other shareholders through the shareholder proxy resolution process would be uncertain on a broad reading of corporate political speech, undermining an important avenue of corporate accountability.

ARGUMENT

I. THE TEST THAT THE CALIFORNIA SUPREME COURT ARTICULATED FOR DEFINING COMMERCIAL SPEECH IS CONSISTENT WITH THE REASONS FOR REGULATING COMMERCIAL SPEECH AND PROVIDES AN ADMINISTRABLE BASIS FOR DISTINGUISHING COMMERCIAL FROM NON-COMMERCIAL SPEECH

The principal difference between the First Amendment protection given to political versus commercial speech is the role of the government in ensuring accuracy. In the realm of political speech, this Court has clearly recognized that there is no role for the government to identify some political ideas as "false" or to create causes of action to allow some ideas to be penalized. *See National Socialist Party v. Skokie*, 432 U.S. 43 (1977). Rather, the political realm depends on competition among ideas to allow some ideas to flourish and some to fail.

In contrast, in the realm of commercial speech, there is a role for government, and that role is to promote the dissemination of accurate facts. *See Central Hudson Gas and Electric Corp. v. Public Service Commission*, 447 U.S. 557 (1980). This role derives directly from the reason that commercial speech has been given First Amendment protection, which is to "assure the flow of accurate information to consumers necessary to the functioning of efficient markets." *See* Burt Neuborne, *The Supreme Court and Free Speech: Love and a Question*, 42 ST. LOUIS U.L.J. 789, 802 (1998). As this Court stated in first recognizing the constitutional import of commercial information:

> So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is a matter of public interest that

> those decisions, in the aggregate, be intelligent and well informed. To this end, the free flow of commercial information is indispensable.

Virginia Pharmacy Board v. Virginia Consumer Council, 425 U.S. 748, 765 (1976).

While "the free flow of commercial information is indispensable" to the proper functioning of the market, *see id.* at 765, that information must be accurate or resources will be allocated improperly, and individuals' expressions of their actual consumer preferences will be thwarted. So, for instance, assume that a consumer would pay more money to fly on an airline that had top of the line maintenance procedures, or an investor would pay more money for the stock of an airline company that invested heavily in maintenance. If an airline can use its public statements—in advertising, in letters to the editors, in speeches or in quarterly or annual reports under the securities laws—to promote itself as investing in maintenance, both consumers and investors are harmed if those representations of fact are false or misleading. Companies that actually do invest more heavily in airline maintenance may not be able effectively to compete on price, if consumers direct their dollars to the "falsely safe" but potentially cheaper airline, thus degrading the "market in airline safety." Investors are harmed by paying a "safety premium" in the stock price that turns out to be fraudulent. Given the role of accurate information in a free-market economy, there "is no constitutional value in false statements of fact." *Gertz v. Welch*, 418 U.S. 323, 339-40 (1974). And, given the role of accurate information in a free-market economy, as a society we permit more regulation of speech related to commercial and securities transactions than in other areas such as elections, the press or religion. *See* Neuborne, *supra* at 801-802.

This case presents the Court with the opportunity to permit the market in corporate social responsibility to continue to develop, by ensuring that consumers and investors who take

social, economic and environmental facts into consideration in their purchasing and investing decisions are well-informed, and cannot be lied to with impunity, or have the facts misrepresented or presented in confusing or misleading fashion. That there are such consumers and investors, and that their numbers are growing, is undeniable. In 1994, an article in The Economist branded this "the era of the corporate image," in which "consumers will increasingly make purchases on the basis of a firm's role in society: how it treats its employees, shareholders, and local neighbourhoods." *Brand New Day*, THE ECONOMIST, June 19, 1994, at 71-72. The kinds of questions Nike faced in 1996 and 1997, leading to this lawsuit, are evidence of concerns by some consumers about how companies' goods are being produced, what the environmental implications are of production, and how the people producing them are being treated, here and around the world. *See* Geoffrey Heal, *Mastering Investment: The Bottom Line to a Social Conscience*, FINANCIAL TIMES, July 2, 2001 (stating that consumers are using their buying power to attain social goals, and that the "concerned consumer" movement "is particularly influential in the human rights and environmental fields, where major clothing and shoe brands, Nike prominent among them, have been boycotted for their use of sweatshop labour . . .").

Academic research confirms a trend among some consumers to make their product choices not simply on their evaluation of the attributes of the products, but on their evaluation of a company's "corporate social responsibility" as well. *See* Sankar Sen and C.B. Bhattacharya, *Does Doing Good Always Lead to Doing Better? Consumer Reactions to Corporate Social Responsibility*, JOURNAL OF MARKETING RESEARCH 225 (Spring 2001). Given this trend, in 1993 companies spent over $1 billion on cause-related marketing, such as marketing that focuses on environmental friendliness, or a commitment to diversity in hiring and promoting, an increase of 150% over cause-related marketing in 1990. *See*

Tom J. Brown and Peter A. Dacin, *The Company and the Product: Corporate Associations and Consumer Product Responses*, 61 JOURNAL OF MARKETING 68 (Winter 1997).

Investors as well use companies' public statements about their social and environmental records to make decisions to buy or sell stocks. The growth of SRI–defined as the integration of social and environmental criteria into the investment decision-making process—has been dramatic over the past few years. By 2001, total assets under professional management in portfolios screened for one or more social issues had risen to $2.01 trillion. Social Investment Forum, *2001 Report on Socially Responsible Investing Trends in the United States*, November 28, 2001, available at http://www.socialinvest.org. Between 1999 and 2001, total professionally managed investment assets grew by 22 percent, while SRI investment assets grew by 35 percent. *See id.* And investors as well as consumers reacted specifically to allegations that Nike's products were being produced in "sweatshop" labor conditions. For instance, given these allegations, and upon investigation, KLD removed Nike in 1997 from the Domini 400 Social Index (an index of 400 firms meant to reflect the large-capitalization socially responsible domestic market).

In its market activities, Nike clearly recognized the commercial import of facts about whether it used "sweatshop labor" or not—the type of facts at issue in this case. Nike's CEO Phil Knight was quoted in 1998 saying that "I truly believe the American consumer doesn't want to buy products made under abusive conditions." *See* Bill Richards, *Nike to Increase Minimum Age in Asia for New Hirings, Improve Air Quality,* WALL ST. J., JAN. 15, 1998, at B10. Mr. Knight attributed concerns about alleged sweatshop labor as a partial reason for Nike's disappointing financial results in 1997 and 1998. *See* Philip H. Knight, Cover Letter to Annual Report to the Shareholders, 1998, available at www.sec.gov (attributing financial results to "Asia, brown shoes, labor practices, resignations, layoffs and boring ads").

Of course Nike or any other company must be able to respond to criticisms of their labor policies by providing facts about those policies in order to reassure concerned consumers and socially responsible investors. Yet that reassurance needs to be based on truthful, accurate and non-misleading information. Nike or any other company should not be able to "plead the First" so that the truth of the facts they assert about their social and environmental records cannot be tested in litigation—just as they would not be able to plead the First to preclude an examination of their statements of fact about their financial results of operations or about product quality, price or safety.

The goal of encouraging accurate corporate disclosure is best achieved by ensuring that the States and the federal government maintain the power to "insur[e] that the stream of commercial information flow[s] cleanly, as well as freely," *Virginia Pharmacy Board*, 425 U.S. at 772, by permitting causes of action for untrue, deceptive or materially misleading statements of fact. *See id.* (recognizing the importance of state consumer protection actions). The test the California Supreme Court articulated does just that, recognizing that promoting accurate consumer information is the core value to be advanced by the commercial speech doctrine and is a necessary condition for the proper functioning of a free-market economy.

A. When a Commercial Entity States Facts About Its Own Products or Operations, in Order to Influence Purchasing Decisions About Either the Product or the Company's Stock, That Is and Should Be Understood to Be Commercial Speech

The California Supreme Court's analysis of commercial speech emphasizes a number of important factors to

distinguish commercial from non-commercial speech. The California Supreme Court emphasized (1) the identity of the speaker; (2) the identity of the audience; and (3) the content of the speech as "factual representations about the business operations, products, or services of the speaker." *Kasky v. Nike, Inc.*, 45 P.3d 243, 256 (2002). *Amici* view these factors as a logical synthesis of this Court's guidance on the distinction between commercial and non-commercial speech, and views them as providing administrable guidance for the courts in future cases.

First, in order to be commercial speech, the statements must be made by a commercial entity, that is, an entity in the business of selling either products or services. This would seem to be a necessary condition for speech to be commercial, and wholly unexceptional. Second, the California Supreme Court suggested that commercial speech "generally or typically is directed to an audience of persons who may be influenced by that speech to engage in a commercial transaction with the speaker." *Kasky*, 45 P.2d at 256. Focusing only on the intended audience may create some conceptual difficulties with this aspect of the Court's analysis, since speech communicated to one audience (to Congress, for instance) will likely be reported to other audiences, including potential consumers and investors. The California Supreme Court may have been closer to the mark in looking at the company's reason for speaking in analyzing the "audience" factors, suggesting that this factor relates to the company's ultimate economic motivation for making statements about its products or services. *See id., citing Bolger v. Youngs Drug Products Corp.*, 463 U.S. 60, 66-67 (1983). As Nike concedes, however, "virtually *everything* a company does is ultimately intended to improve its financial bottom line." *See* Brief for the Petitioners ("Pet. Br.") at 22 (emphasis in original). Thus, it may be that the "intended audience/economic motivation" factor is most useful to exclude certain types of speech from consideration as commercial speech (such as speech directly to regulators).

The third factor, however, in conjunction with the first and second, really specifies what is and is not commercial speech, in *amici*'s view, that is "representations of fact about the business operations, products, or services of the speaker." *Kasky*, 45 P.2d at 256. First, facts about a company's own operations can fairly readily be distinguished from the company's general political views and opinions. If Nike states that "globalization is a good thing that brings excellent benefits to the people in developing countries," that is Nike's political opinion, not a representation of fact about Nike's own operations. When, in contrast, Nike states that "Nike pays the minimum wage in every country in which it operates," that is a statement of fact about Nike's own operations which should properly be understood as commercial speech. It is these facts about a company's social, economic and environmental records that are animating concerned consumers and SRI investors to enter into commercial transactions with a company, or not, and thus it is the truth of these factual assertions that must be protected in the market.

In response, Nike makes a number of arguments. First, Nike broadly argues that the government has no legitimate role in protecting the accuracy of social facts, even if they do inform purchases by concerned consumers and investors, since these consumers are "purchas[ing] (or boycott[ing]) goods for *non*-economic reasons." Pet. Br. at 22 (emphasis in original). But that is precisely the point. People are using Nike's statements of fact about its labor practices in Asia to inform their commercial (purchasing) behavior. While Nike makes this statement in support of its general argument that this speech is unconnected to the regulation of commercial transactions, by its own admission there are consumers

buying or not buying goods for non-economic reasons.[2] Thus the states and federal government have a role to play to structure legal incentives so that those statements of fact about those non-economic reasons are as accurate as possible and not misleading.[3]

Second, Nike also argues that the only commercial facts that can be properly regulated in a consumer protection context are those that refer specifically to the product, such as its price, availability, or suitability. Pet. Br. at 24. Yet, this Court has long recognized that consumer protection laws are meant to address consumers' individual evaluations about what matters to them in a purchasing decision, and cannot be reduced only to a matter of the price and quality of goods. In

[2] Nike repeats the argument that regulating the truth of statements of fact about labor conditions is unconnected to the state's power to regulate commercial transactions because the information is affecting people's moral judgments first, and then their "purchasing choices only secondarily, if at all," Pet. Br. at 36, and again at page 46 (these "statements . . . affect consumer behavior only indirectly and only for a subset of listeners."). Nike evidently recognizes the importance of this argument to its conclusion that this is not commercial speech. And yet *amici* note that Nike provides no support for its statement that "[t]here is only the most attenuated link between public statements on important social, political, and moral issues—which generate heated responses and debate—and consumer purchasing decisions." Pet. Br. at 36. Nor could Nike support that blanket generalization, for it is clearly incorrect in today's market. *See supra* pages 5-6.

[3] To use Nike's term that these factors are "non-economic" is not to adopt an implication that they do not have "bottom line" consequences. All investors, and certainly SRI investors, make decisions based on intangible factors, such as the quality of management, the reputation of a company, and increasingly the corporate social responsibility reputation of a company. Domini and other social investors believe that careful attention to social factors can help identify companies with higher quality management, that can produce higher returns to investors. Again this points to the commercial importance of the kind of information at issue in this case.

Federal Trade Comm'n v. Algoma Lumber Co.,291 U.S. 67 (1934), this Court rejected an argument that a buyer of white pine was not prejudiced by being supplied with yellow pine, even if the quality of the two goods was the same (which the evidence in that case had not demonstrated), and even if the buyer might have saved money:

> The consumer is prejudiced if upon giving an order for one thing, he is supplied with something else . . . In such matters, the public is entitled to get what it chooses, though the choice may be dictated by caprice or by fashion or perhaps by ignorance.

Algoma Lumber, 291 U.S. at 78. If concerned consumers are purchasing Nike shoes based on Nike's representations of fact about labor conditions in its factories because consumers prefer to buy goods made in humane conditions–even if those consumer preferences are "dictated by caprice or by fashion or perhaps by ignorance"—then the seller's statements of fact about the conditions of production matter in that commercial transaction, and their accuracy can properly be regulated.

Third, Nike suggests that the "line between fact and opinion is so hazy" that companies in Nike's position would have little guidance about what they could and couldn't say without fear of potential deceptive business practices claims. Pet. Br. at 32. While it is true that this Court has recognized that in some instances distinguishing between a fact and an opinion can be analytically difficult, *see Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 168 (1988), this distinction is used regularly, including by this Court. *See Peel v. Attorney Registration and Disciplinary Comm'n of Illinois*, 496 U.S. 91 (1990); *Milkovich v. Lorain Journal Co.*, 497 U.S. 1, (1990); *Hustler Magazine v. Falwell*, 485 U.S. 46 (1988). Moreover, the category "facts" here is limited to facts about Nike's own products and services. And even if the great number of facts associated with the global scope of Nike's business makes it costly for Nike to speak with confidence

about the facts, that cost should be viewed as a normal business expense, perhaps increasing as business becomes more global, rather than as an inherently unfair burden. *Amici* notes that Nike has not argued that it is difficult to say whether the statements at issue in this case are facts or opinions, rather that as a general matter the distinction does not give enough guidance. Presumably if it was difficult to separate facts from opinions in this case, Nike would have so stated. The law can never be reduced to mechanistic, mathematical precepts, and so there will always be areas of discretion and dispute. But in the vast majority of cases the line between "facts about a company's own operations" and "opinions about general political and social issues" will provide workable guidance for companies and courts.

Finally, Nike argues that since opinions are informed by facts, and since it won't be able to discuss the facts of its own operations without fear of litigation, it will be disabled from shaping public opinion and participating in political debate. Pet. Br. at 32-33. Yet, Nike is in a good position to judge the limits of its speakers' knowledge of its global operations, and thus to express whatever qualifications are necessary in order to make statements of fact about its own operations not misleading as it participates in shaping public opinion and participating in political debate. As a public company, Nike is already under obligations imposed by the securities laws to ensure that all of its public statements are accurate, do not contain material misstatements of fact nor material omissions, and so are not misleading. *See infra*, pages 22-27. The heart of the issue, *amici* suggest, is not whether Nike will be inhibited in stating facts about its operations if the California Supreme Court ruling is upheld, but rather that Nike will be inhibited in *misstating* the facts if the California Supreme Court ruling is upheld.

In short, *amici* respectfully submit that the California Supreme Court has articulated an administrable synthesis of this Court's holdings to develop a process of analysis for

distinguishing commercial from non-commercial speech, and that such a process rightfully emphasizes the nature of the speaker as a commercial entity; the nature of the potential audience of consumers (and we would add, investors) and the company's economic motivation for speaking; and the content of the speech at issue being statements of fact about the company's own operations, products or services.

II. GRANTING FULL FIRST AMENDMENT PROTECTION TO COMMERCIAL SPEECH WOULD UNDERCUT ESSENTIAL DISCLOSURE AND REPORTING OBLIGATIONS UNDER THE SECURITIES ACT, THE EXCHANGE ACT AND VARIOUS SEC RULES AND REGULATIONS.

Nike's position in this litigation, if upheld, not only threatens important consumer protection values, but threatens to undermine capital market regulation as well. Nike apparently glimpses some of the implications of its arguments for securities regulation, and therefore suggests in a footnote that in "contrast [to state consumer protection legislation], government may have a freer hand in regulating financial statements that are immediately incorporated by financial markets into stock prices." Pet. Br. at 34, n.9. And yet, by what analytic principle would government have that freer hand if what is being developed is a constitutional limit on government's power? The essence of Nike's argument is that government may not regulate companies' statements of fact about their own operations where those facts touch on matters of "public concern," except by showing the statements were made with actual malice. Pet. Br. at 43 (stating that "[w]hen even purely commercial speech is thus 'inextricably intertwined' with noncommercial speech on matters of public concern, 'the entirety' of the speech must 'be classified as noncommercial,' *quoting Board of Trustees v. Fox*, 492 U.S. 469, 474 (1989)). What are the implications on securities regula-

tion, through, of treating any speech on a matter of "public concern" as political speech, subject to the strictest constitutional scrutiny? The federal securities laws reach much further than "financial statements that are immediately incorporated by financial markets into stock prices," and touch on many matters of public concern. Indeed, given recent events, that financial statements are accurate is itself a matter of public concern, suggesting that on Nike's theory even statements of fact about a company's financial results would not be commercial speech. As the following discussion indicates, there are quite serious implications from Nike's position for securities market regulation, deserving much more thought than treatment in a footnote would suggest.

A. Affording Full First Amendment Protection to Any Corporate Speech that Touches on a "Public Concern" Could Cast Into Constitutional Doubt the Structure of Compelled Securities Disclosure

The core regulatory approach taken in the federal securities laws is compelled disclosure of specified information at specified times: when a company is newly issuing securities (stocks or bonds); in quarterly and annual reports; in proxy statements in conjunction with the company's annual meeting; and in proxy statements or tender offer disclosure in conjunction with extraordinary transactions such as mergers, acquisitions or tender offers. *See* Securities Act of 1933, §§ 5, 7, 10, Schedules A & B, 15 U.S.C. §§ 77e, 77j, 77aa (1994); Securities Exchange Act of 1934, §§ 12(b)(1), 12(g)(1), 13, 14, 15, 15 U.S.C. §§ 78*l*(b)(1), 78*l*(g)(1), 78(m), 78(n), 78(o) (1994). The instructions for developing each of the various types of disclosure documents are incorporated in one omnibus regulation, Regulation S-K ("Reg. S-K"), which specifies precisely what information needs to be disclosed in each type of disclosure document and in what format. *See* Reg. S-K, 17 C.F.R. §§ 229.10-229.702 (1998).

Nike's footnote suggestion that the Court can adopt its expansive view of non-commercial speech (corporate statements touching on an issue of "public conern," Pet. Br. at 43), without affecting securities regulation apparently rests on the misconception that the only compelled disclosure under the federal securities laws is of financial statements. *See* Pet. Br. at 34, n. 9. This is a serious misconception, since under Reg. S-K both quantitative (financial) and qualitative information is required to be disclosed. For example, the issuer must disclose general information about its business; the competitive risks facing the business; legal proceedings involving the company, with specific attention to environmental proceedings; the experience and background of management and potential conflicts of interest; the structure of the board of directors; and so forth. *See* Reg. S-K, Item 101, 17 C.F.R. § 229.101 (1998) (description of business); *id.*, § 229.103 (legal proceedings); *id.*, §§ 229.401-405 (information on directors and management, including executive compensation and conflicts of interest).

Moreover, even when disclosing quantitative information, issuers are now required to provide a narrative analysis of their financial results, including a discussion of trends, future risks, or contingencies that might affect those results (called "Management's Discussion and Analysis", or "MD&A"). *See id.*, § 229.303. The Sarbanes-Oxley Act of 2002 added yet another layer of qualitative disclosure, including, among other items, disclosure concerning a company's code of ethics. *See* Sarbanes-Oxley Act of 2002, § 406 (2002).

In the subsequent sections of this Brief, we develop some specific concerns about the implications of Nike's argument on specific aspects of Reg. S-K. And yet there is a general concern as well: if the Court defines any corporate speech on a matter of "public concern" as non-commercial speech, can the SEC still compel disclosure of that speech? The Court's cases in the charitable solicitation area suggest not (or at least

not without litigation over any contested disclosure item). In those cases, compelled disclosure of the percentage of funds reaching a charity/beneficiary has been found unconstitutional, given that charitable solicitations are fully protected speech. *See Riley v. National Federation of the Blind*, 487 U.S. 781, 799 (1988). Moreover, this Court's holding in *Pacific Gas and Electric Co. v. Public Utilities Comm'n of California*, 475 U.S. 1 (1985) also suggests not. In that case a plurality of this Court struck down an order by the Public Utility Commission of California that had required the utility, PG&E, to include customers' statements about rates four times a year in PG&E's mailings. *Id.* at 7. This Court's holding was based, in significant part, on the view that the government's authority to compel non-commercial speech is limited. *See id.* at 16-19.

And yet, looking at the categories of qualitative information that the SEC currently requires, *supra*, these are all matters of "public concern," and thus not commercial speech according to Nike's definition. *See* Pet. Br. at 43. In light of the difficulties in the capital markets over the last year, as affected by problems at Enron, WorldCom, Tyco, Xerox, and HealthSouth, even such bedrock corporate governance issues as accounting practices, executive compensation, and accounting for stock options are clearly matters of serious "public concern," and are currently matters of intense public debate. Information about each of these items is required to be disclosed under Reg. S-K. *See* Reg. S-K, items 401-405, 17 C.F.R. §§ 229.401-405 (1998). Is each of these compelled disclosure items now constitutionally suspect, under Nike's theory, because it is a matter of public concern and thus not commercial speech? Is each now subject to challenge in litigation as an impermissible content-based regulation that is not narrowly tailored? Given *Riley* and *Pacific Gas & Electric Co.*, *amici* believes that a broad ruling by this Court adopting Nike's theory of non-commercial speech could have serious implications for the SEC's power to require

companies to provide information to the capital markets, at a time when restoring investor confidence in the accuracy of information in the markets is critical.

It is possible that access to the securities markets would be held to be analogous to access to federal broadcast licenses, in which case the government has been found to have broader powers to compel speech as a condition of access. *See Turner Broadcasting Sys., Inc. v. F.C.C.*, 512 U.S. 622 (1994) ("must carry provisions" served important government interests by preserving free broadcast television, ensuring widespread dissemination of information and promoting fair competition). Moreover, following a discussion of the commercial speech doctrine, a plurality of this Court has pointed to securities regulation as "another area" of permissible regulation of speech. *See Dun & Bradstreet, Inc. v. Greenmoss Builders*, 472 U.S. 749, 758 n.5 (1985). The suggestion in *Dun & Bradstreet* that the regulation of speech in the securities field was distinct from the regulation of commercial speech generally was explicitly adopted by the Court of Appeals for the District of Columbia Circuit in *Securities and Exchange Comm'n v. Wall Street Publishing Institute, Inc.*, 851 F.2d 365, 372 (D.C. Cir. 1988). So compelled disclosure under the securities laws of specific information of "public concern" might not clearly be constitutionally impermissible if Nike's views prevail. And yet the commercial speech doctrine generally suggests that some areas of speech can be extensively regulated precisely because that speech is understood as tied to the underlying commercial transactions (here buying and selling securities or communicating with shareholders), and thus is commercial speech. If the "anchor" of commercial speech is cut loose, the source of continuing regulatory authority would also be set adrift. Thus, while securities regulation is not directly before the Court, *amici* respectfully submit that the potential unintended capital market consequences of a broad ruling in Nike's favor must be considered carefully.

B. Granting First Amendment Protection to Corporate Speech Would Make Many Important Disclosure Obligations Involving Political Matters Inherently Unreliable

Item 101 of Regulation S-K requires that companies provide in various periodic reports and offering documents a detailed discussion of the general business of the company. In addition to a general narrative description of the "business done and intended to be done" by the company, Item 101 requires disclosure of material portions of the business that might be affected by government contracts, "positive and negative factors pertaining to the competitive position" of the business and material effects resulting from compliance with Federal, State and local environmental laws. *See* 17 C.F.R. § 229.101(c)(1)(i), (vii), (ix), (x), (xii).

The potential—if not inherent—political nature of some of those items, however, makes the content of those disclosures far too vulnerable to corporate manipulation and deception, at least if corporate speech were afforded full First Amendment protection. For instance, even though compliance with environmental laws in the U.S. might have a material adverse effect on Nike's expenditures and earnings, Nike might color its statement with a political judgment about those environmental laws that could reverse the substantive impact of the disclosure itself. Thus, implicitly embracing a position that most current U.S. environmental laws violate some unspecified Constitutional mandates, Nike might state, "Nike's expends only minimal resources in complying with U.S. environmental laws that do not run afoul of the Constitution." To the extent that statement remains inextricably linked to a political comment, under Petitioner's reading of the First Amendment, Nike's disclosure would receive full protection regardless of its (intentionally) deceptive nature. And what if companies simply refuse to comment on their use of child labor, or toxic releases, or whether they have Superfund sites, or even whether they expense stock options? Could they be compelled to, if they claim that compelled disclosure of "non-commercial" information is unconstitutional?

As investors learn that these particularly vulnerable disclosure categories almost beg for manipulation due to the political nature of the subject matter addressed, investors may simply discount or ignore company responses on those matters altogether. In addition, this would remove the market advantage that corporations with exemplary social or environmental records should enjoy. *See* Joseph A. Franco, *Why Antifraud Prohibitions Are Not Enough: The Significance of Opportunism, Candor and Signaling in the Economic Case for Mandatory Disclosure*, 2002 COLUM. BUS. L. REV. 223, 258 (". . . .[O]pportunistic issuers adversely affect economic efficiency by devaluing the disclosure of issuers generally, and in particular the disclosure of candid issuers."). The problem raised here addresses something more than the lack of a viable action for fraud based on material misstatements or omissions. Instead, the problem focuses on the futility of even asking companies to answer questions involving inherently political matters, matters of "public concern," if full First Amendment protection applies. In the end, despite a continuing need for full and fair disclosure regarding certain potentially or inherently political matters, granting First Amendment protection to corporate speech would render unreliable many important disclosure requirements that are necessary for investors to make informed choices.

C. Using the First Amendment to Create a "Super Safe Harbor" for Forward Looking Statements Would Undermine the Usefulness of Management's Discussion and Analysis.

Item 303 of Regulation S-K sets forth the detailed disclosure requirements relating to management's discussion and analysis of current operations and plans for the future.

See 17 C.F.R. § 230.303. MD&A disclosures are required for quarterly and annual reports for reporting companies as well as for prospectuses related to various securities offerings. According to the SEC, the detailed discussion is intended to provide "in one section of a filing, material historical and prospective textual disclosure enabling investors and other users to assess the financial condition and results of operations of the registrant, with particular emphasis on the registrant's prospects for the future." *See* Management's Discussion and Analysis of Financial Condition and Results of Operations, Sec. Act. Rel. No. 33-6835, 1989 WL 258977 (SEC May 18, 1989). To that end, the MD&A must include a disclosure of trends and uncertainties likely to have a material negative effect on the company in addition to positive trends that management foresees. *Id.*

While liability might arise for material false or misleading statements and omissions under Rule 10b-5 or Sections 11 and 12 of the Securities Act when companies discuss these trends and uncertainties, *see e.g. Wallace v. Systems & Computer Tech. Corp.*, 1997 WL 602808, Fed. Sec. L. Rep. (CCH) ¶99,578 (E.D. Pa. 1997)(failure to comply with Item 303 of Regulation S-K can amount to a Rule 10b-5 violation), various "safe harbor" provisions exist that, under certain conditions, insulate companies from liability based on "forward looking statements" or projections. *See* Securities Act Rule 175; Exchange Act Rule 3b-6. For example, Exchange Act Rule 175 and Securities Act Rule 3b-6 shield certain forward looking statements from liability, unless those statements were not made in "good faith" and "with a reasonable basis." 17 C.F.R. §§ 230.175, 240.3b-6. Exchange Act Section 21 E, though unavailable in the context of an initial public offering, goes even further and provides a safe harbor for any forward looking statements accompanied by "meaningful cautionary statements" that identify important factors potentially affecting management's predictions or forecasts. *See Ehlert v. Singer*, 245 F.3d 1313 (11th Cir.

2001). Even if no cautionary language were used, however, Section 21E provides that liability based on forward looking statements will only result if the statements were made with "actual knowledge" that the statements were false or misleading.

Extending broad First Amendment protection to corporate speech, however, would create a "Super Safe Harbor." Through the "meaningful cautionary statements" mechanism, "good faith" or "rational basis" requirements and even an "actual knowledge" threshold for fraud liability, current safe harbor provisions attempt to provide a balance between investors' desire for "soft information" not contained in raw financial data, including management's views of future trends and contingencies, and management's need for reasonable protection from liability for providing that analysis. But completely shielding from liability those corporate statements that touch some political chord would thwart the delicate balance the SEC rules intend to promote. Unaccompanied by "meaningful cautionary statements", even a bad faith disclosure made with "actual knowledge" of its falsity might be sheltered from liability by the First Amendment (to the extent that strict scrutiny might require more than actual malice, perhaps encompassing reliance or actual damages). To the extent companies could utilize the Super Safe Harbor of the First Amendment to mislead investors and generate falsely optimistic expectations, granting politically tinged corporate speech full First Amendment protection would undercut the usefulness of the MD&A requirement at the outset.

III. EXTENDING FULL FIRST AMENDMENT PROTECTION TO CORPORATE SPEECH WOULD CONFLICT WITH THIS COURT'S PRIOR RULINGS BY SEVERELY CURTAILING OR RENDERING UNCONSTITUTIONAL VARIOUS CAUSES OF ACTION PROVIDED UNDER THE SECURITIES ACT, THE SECURITIES EXCHANGE ACT, AND VARIOUS SEC RULES

A. Corporations Could Easily Sidestep Securities Act Anti-Fraud Provisions Designed to Promote the Public Interest and Protect Investors by Encouraging Full and Accurate Disclosure when Companies Sell Stocks and Bonds to the Public.

Construing the First Amendment to protect corporate speech that touches any public concern would severely curtail the availability of civil causes of action under Sections 11 and 12 of the Securities Act. Section 11 establishes a civil cause of action if a registration statement, at the time it was declared effective, "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein not misleading." 15 U.S.C.A. § 77(k). The issuer, its directors, its officers who sign the registration statement, the underwriters and any experts named in the registration statement may be liable to any person who purchased the security. While defendants other than the issuer have a "due diligence" defense that may enable them to escape liability if they acted reasonably in investigating the statements in the registration statement, the issuer remains subject to strict liability for any material misstatements. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-82 (1981).

Section 12 provides additional anti-fraud protection under the Securities Act. An investor maintains a right of rescission

against any person who offers or sells a security on the basis of a prospectus or oral communication that includes "an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading." 15 U.S.C.A. § 77(l). In contrast to the strict liability standard applied to issuers under Section 11, defendants (including the issuer) may escape liability under Section 12 by demonstrating they did not know, and with the exercise of "reasonable care" could not have known, about the material misstatement or omission. *Id.*

Protecting corporate statements "inextricably intertwined" with political speech (Pet. Br. at 43) would limit the availability of each of those anti-fraud causes of action. To the extent that the misstatement at issue was sufficiently connected to political speech, the misleading statements would be immunized by the First Amendment rather than subjected to the strict liability standard imposed under Section 11. Even the "due diligence" and "reasonable care" requirements—provided under Sections 11 and 12 respectively—might no longer be relevant. As long as the misstatements were sufficiently blanketed in political commentary, the exercise of reasonable care and due diligence would simply be unnecessary. Rather than engage in costly due diligence efforts, potentially liable parties might insist on the cheaper route of intertwining the most troublesome disclosures with political speech. If First Amendment concerns trump the anti-fraud provisions in the Securities Act, certain issuers will undoubtedly engage in an artful alchemy of mixing just enough political commentary with any potentially fraudulent disclosure in order to escape liability.

The ability of issuers to engage in that artful alchemy should not be underestimated. Despite the specific disclosure and reporting obligations set forth in the Securities Act, the Exchange Act and SEC rules, many disclosures that may

seem purely factual or commercial in nature can be couched in qualitative language that touches explicitly upon political concerns. *See* Sections II B &C, *supra* for a discussion of the particular disclosures required by Regulation S-K as applied to the Securities Act and the Exchange Act; *see also* Burt Neuborne, *The First Amendment and Government Regulation of Capital Markets,* 55 Brook. L. Rev. 5, 10-13 (1989). Indeed, Petitioner's very case rests on the proposition that some commercial speech remains so closely connected with political commentary that the total exposition of ideas becomes an amalgam that deserves full First Amendment protection. Pet. Br. at 43. And if that protected speech amalgam of commercial and political speech exists when Nike responds to reporters' questions about Nike's overseas labor practices, why should we not expect the same amalgam to present itself when Nike responds to disclosure requirements regarding labor practices or environmental litigation set forth in U.S. securities laws? As companies gain expertise in insulating disclosures from liability under the First Amendment, the anti-fraud provisions contained in the Securities Act will become nugatory.

B. The Anti-Fraud Provisions Under the Exchange Act and SEC Rules Promulgated Thereunder, Designed to Promote the Public Interest and Protect Investors by Encouraging Full and Accurate Information in the Trading Markets, Such as the New York Stock Exchange and NASDAQ, Could be Severely Debilitated by a Broad Ruling.

Providing broad protection to corporate speech under the First Amendment could also severely hamper the viability of causes of action arising under Sections 10(b) and 14 of the Exchange Act and related SEC Rules. Section 10(b) of the Exchange Act and SEC Rule 10b-5 generally prohibit the use of a materially misleading statement, omission or any

manipulative or deceptive device in connection with the purchase or sale of securities. 15 U.S.C. 78(j); 17 C.F.R. § 240.10b-5. This Court has long recognized an implied private cause of action under Rule 10b-5 that covers statements in a broad range of venues, including statements to the press, statements in periodic reporting in annual or quarterly statements, or statements over the Internet. Imposing 10b-5 liability on an issuer, its directors or executive officers requires, among other elements, a demonstration that the misstatement or omission was made with "scienter" (i.e., that the defendant intentionally or recklessly caused a material misstatement or omission). *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). Thus, while Rule 10b-5 covers a broad range of activities, the level of proof necessary to sustain a claim remains quite high.

Section 14(a) and SEC Rule 14a-9 prohibit the use of materially misleading statements or omissions in connection with the solicitation of proxies in connection with shareholder votes. Again, this court has long recognized an implied right of action arising under Rule 14a-9 and remedies include both damages and injunctive relief. *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 171 (1994); *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1086-87 (1991). Unlike a 10b-5 claim, however, establishing liability under Rule 14a-9 does not require demonstrating scienter on the part of the issuer, its directors or executive officers. Instead, establishing negligent conduct suffices to maintain an anti-fraud claim under Rule 14a-9. *Shidler v. All American Life & Financial Corp.*, 775 F.2d 917, 926 (8th Cir. 1985).

Shielding corporate speech under the First Amendment, however, drastically reduces the availability of private causes of action under Sections 10 and 14. With respect to a 10b-5 claim, even if an investor could establish the requisite scienter, a disclosure sufficiently connected to a public

concern would potentially insulate the statement from liability, since strict scrutiny might require demonstrating more than scienter (including reliance). For instance, Nike might state in the "Description of Business—International Markets" section of its annual report, "As part of Nike's commitment to promoting freedom and democracy, Nike remains dedicated to expanding its operations in lesser developed African nations." Even if Nike had no intention of expanding its operation in Africa, and made the statement with knowledge of its falsity, the statement could nonetheless constitute "commercial speech [that] is thus 'inextricably intertwined' with noncommercial speech on matters of public concern" so as to deserve full First Amendment protection. Pet. Br. at 43. Despite Petitioner's reading of the First Amendment, that false statement seems to represent the very kind of fraudulent speech that Rule 10b-5 intends to prohibit.

The problem becomes even more severe in the context of 14a-9 claims that do not require scienter. If the same statement about Nike's international plans were contained within a proxy solicitation, liability would arise under 14a-9 simply by demonstrating the statement was material and made negligently. In contrast to a standard 10b-5 claim, the Exchange Act and the SEC Rules intend to afford investors a heightened level of protection from deceptive speech in the context of proxy solicitations by reducing the level of culpability necessary to support a claim. *Virginia Bankshares,* 501 U.S. at 1103-04. While the securities laws as interpreted by this Court and the SEC contain a range of causes of action with different levels of culpability, embracing broad First Amendment protection for corporate speech would risk eliminating much of the force behind those distinctions. Despite the increased protection that the securities laws extend to proxy contests, corporations could once again avoid liability by couching potentially risky disclosures in political speech.

C. Adopting Petitioner's "Actual Malice" Standard Would Conflict with This Court's Prior Rulings By Rendering Unconstitutional Various Provisions of the Securities Act, the Exchange Act and Various SEC Rules.

In order to determine if the First Amendment protects commercial speech that implicates some public concern, Nike advocates adopting an "actual malice" standard that uses knowing falsity or recklessness to assess whether or not corporate speech falls outside the umbrella of Constitutional protection. Pet. Br. at 43. According to Petitioner's Brief, the California laws under which the California Supreme Court held Nike ultimately accountable "violate the First Amendment because they would impose strict liability, or at least liability based on mere negligence, for misstatements on matters of public concern." Pet. Br. at 44.

But the precise reasons Nike offers to invalidate the California laws would also render unconstitutional various sections of the Securities Act, the Exchange Act and SEC Rules. After all, issuer liability under Sections 11 and 12 of the Securities Act are predicated upon a strict liability theory. Moreover, the "due diligence" and "reasonable care" defenses available to non-issuer defendants would clearly not reach the level of recklessness that the "actual malice" standard entails. Similarly with respect to liability under Section 14 of the Exchange Act and Rule 14a-9, the negligence standard on its face would fail to surmount the recklessness hurdle. Despite the numerous cases in which this Court has embraced those same causes of action, Nike would have this Court overrule each of those prior decisions and declare unconstitutional the primary sections of the Securities Act, the Exchange Act and SEC Rules under which investors seek relief from securities fraud. Thus, adopting Nike's proposal for an "actual malice" standard would conflict with a long-line of this Court's prior

decisions and leave the accuracy of information in the securities markets at risk, at a time when restoring confidence in the markets is of the utmost importance.

IV. EXTENDING FULL FIRST AMENDMENT PROTECTION TO CORPORATE SPEECH COULD HAVE PARTICULARLY SERIOUS IMPLICATIONS FOR PROXY REGULATION

Finally, *amici* are particularly concerned about the potential impact of a broad ruling upholding Nike's definition of non-commercial speech on the proxy process, particularly shareholders' continuing access to that process. Companies communicate with their shareholders in conjunction with the annual meeting or extraordinary transactions such as mergers in statements called "proxy statements," the contents of which contain compelled disclosure. Thus, the same issues concerning compelled disclosure discussed above need to be considered. *See supra*, at 14-17.

There is, however, another aspect to the process that needs to be considered, and that is the power of shareholders to require companies to include shareholders' proposals in the company's proxy statement for action at the annual meeting (called "shareholder resolutions"). This is an important tool regularly used by shareholders to encourage stronger corporate governance and corporate social responsibility. *Amici* regularly use shareholder resolutions to bring social, environmental, economic and corporate governance issues to the attention of other shareholders. This "proxy season" has seen a record number of shareholder resolutions introduced in reaction to the recent corporate governance problems at many leading companies. Claudia H. Deutsch, *Revolt of the Shareholders: At Annual Meetings, Anger Will Ratchet Up a Notch*, N. Y. TIMES, Feb. 23, 2003, § 3 (Money & Business), at 1. Examples of corporate governance shareholder resolutions introduced in 2003 include resolutions "at General Electric to trim severance packages, [at] Citigroup to eliminate golden parachutes, [at] Sprint to stop repricing the stock options granted to management and [at] Delta Air Lines to charge stock options against earnings." *Id.* Some are more overtly political, such as a resolution at Halliburton which asks the Board to review potential financial and reputational risks arising from conducting business in Iran, given that country's alleged support of terrorists. *Id.* Many shareholder proposals that *amici* have introduced seek information from companies on their environmental or "sweatshop related" risks, or ask companies to report on their labor and diversity statistics, or other matters concerning their social performance.

Since all of these shareholder resolutions are matters of public concern, the ability of shareholders to continue to have their views communicated in light of cases such as *Riley* and *Pacific Gas and Electric Co.*, which have struck down compelled disclosure of political speech, must be considered in any evaluation of Nike's expansive definition of political speech. Particularly given the events in corporate governance over the last year, this is not the time to undermine shareholders' power in corporate governance, or to loosen constraints of accountability on corporate management.

CONCLUSION

For the foregoing reasons, the judgment of the California Supreme Court should be upheld.

Respectfully submitted,

JAMES E. PFANDER *
CYNTHIA A. WILLIAMS
THE UNIVERSITY OF ILLINOIS,
COLLEGE OF LAW
504 East Pennsylvania Avenue
Champaign, IL 61820
(217) 333-8347

ADAM M. KANZER
General Counsel
DOMINI SOCIAL INVESTMENTS LLC
536 Broadway, 7th Floor
New York, N.Y. 10012

MICHAEL R. SIEBECKER
HUNTER COLLEGE
695 Park Avenue
New York, N.Y. 10021

* Counsel of Record